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ANALYSIS OF BANK HOLDING COMPANY TOWARDS STATE-OWNED BANKS IN COMPLIANCE WITH SINGLE PRESENCE POLICY

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Abstract— *In order to establish a solid and stabile banking system, improve affectivity in monitoring role and preparation before the implementation of Basel III regulation, Bank Indonesia implemented policy to regulate ownership of banks which operate in Indonesia. The policy stated that one single entity is restricted to solely holds majority share of more than one bank. This regulation also applies to four state-owned banks (BNI, Bank Mandiri, BRI, and BTN) which majority shareholders for those banks is the government of Indonesia. On February 2011, ministry of BUMN decided to operate a virtual holding in order to comply with PBI No. 8/16/PBI/2006. This study focus on the form of the holding company, scrutinizing the impact of current operating holding company towards the functioning of its subsidiaries, the four state-owned banks, and towards the implementation of minimum capital adequacy ratio in accordance to Basel III. With the purpose to identify the impact of virtual holding existences, the valuation performed prior to and after the virtual holding company operates, resulting from discounted cash flow to equity method Vbefore for BNI; Bank Mandiri; BRI and BTN is 79 trillion Rupiah; 143 trillion Rupiah; 285 trillion rupiah and 7.420 trillion Rupiah and Vafterfor BNI; Bank Mandiri; BRI and BTN is 92 trillion rupiah; 163 trillion rupiah; 288 trillion rupiah; and 7.826 trillion rupiah. The result of the valuation demonstrates that there is insignificant increase of value upon each of four banks. Whereas to observe the capital adequacy, projected CAR analysis for 8 years was performed towards four state-owned banks. The projection resulting two of four banks' CAR will be far below minimum capital adequacy requirement as regulated by Basel III.With CAR level in 2019 of 19.64% for BNI, 7.57% for Bank Mandiri, 10.05% for BRI, and 13.26% for BTN. Based on the calculation, the role of virtual holding company remains unsupportive upon performance of capital adequacy in accordance to Basel III for four state-owned banks. Therefore, the form of virtual holding company should be replaced by a fully functioned holding company.Within the implementation of fully function holding company formation, government through ministry of state-owned companies ought to prepare one entity as a holding company for the four state-owned banks, appoint which chosen state-owned bank to take the role as holding company, perform share-swap, complete the firm formation procedure as holding company, and form a organization structure.*

Keywords: Single Presence Policy, bank holding company, bank valuation, Basel III

I. INTRODUCTION

Indonesia's economy since 1945 is still very vulnerable, the government in its efforts to form a stable economy in Indonesia doing several things, one of which is to issue a policy of deregulation and simplify the bureaucracy in the financial sector and the economy. As the turning point of a variety of banking policy, in 1988, the government and Bank Indonesia further action by issuing a policy package October 27, 1988 (Pakto 88). (Unit Khusus Museum Bank Indonesia). In the policy package, the employer is given broad permission to establish a bank in which it is only by having a very small capital, consequently the number of banks operating in Indonesia soared. Occur imbalance number of banks that operate with the bank supervisory authorities allow a lot of moral hazards in the banking industry. Until the end of banking in Indonesia is faced with the 1998-2000 economic crisis that brought national banks to take certain steps in order to get out of the crisis, consolidation is a way that can be done to give a little power when it's on the foundation of banking.

While on international banking, in response to global crisis, the Bank for International Settlements Basel II regulatory update to Basel III, which the Basel Committee stated that the objectives of this regulation is to enhance understanding of key supervisory issues and improve the quality of banking supervision at all world.(Bank for International Settlements, 2009).

After experiencing a financial crisis in 1998, Indonesia's financial system, especially the healthy and stable banking system though not fully recovered. Resilience of the Indonesian financial system is still focused on the banking sector, especially the big banks, so if there is problems in the banking sector may have a systemic impact for both the bank itself or to the economy of Indonesia. (Bank Indonesia, 2010).

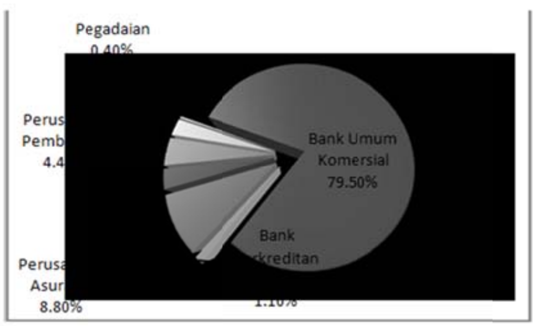

Figure I-1. Financial Institution Asset Composition

Regarding to the system of financial sector in Indonesia which focuses on Commercial Banks, banking Indonesia demanded a stable and healthy in any condition. To improve the economy of Indonesia after the crisis and support the passage of a reliable banking Indonesia, Bank Indonesia Indonesia Banking Architecture as a form of follow-up to the desired owned banking structure both short and long term. Some of the efforts made by the API in order to build a strong banking system is to define the terms such as Single Presence Policy and the provisions of minimum bank capital. Bank Indonesia Regulation (PBI) No. Ownership of the policy 8/16/PBI/2006 Single (Single Presence Policy) is a policy which requires that where a shareholder is allowed to control only the majority shareholder in a public bank, this policy applies to the owner of the public good, and foreign governments that aim, improve the effectiveness of banking supervision and encourage consolidation.

A. Company Profile

Companies that are the object of this study are four national banks, each of the four bank's shares owned by one shareholder, namely the Republic of Indonesia and is under the control of the Ministry of State Owned Enterprises. Four national banks are:

• Bank Negara Indonesia.
• Bank Mandiri
• Bank Rakyat Indonesia
• Bank Tabungan Negara

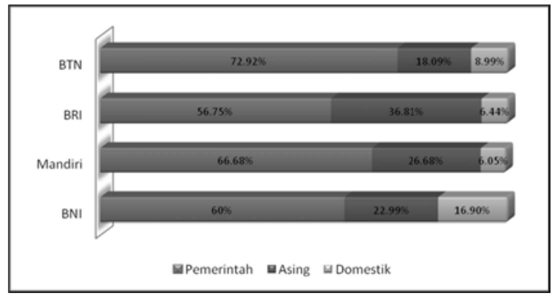

Figure I-2. Bank BUMN Shareholders' Portion

1) State-Owned Enterprises

According to Law No. 19 In 2003, the State-Owned Enterprises, hereinafter referred to as BUMN, is a business entity in which all or most of the capital is owned by the Republic of Indonesia through direct investments originating from the separated state property. As a government institution that has the duty and responsibility in order to manage state assets, the Ministry of BUMN has a vision of "Enhancing the role of state as an instrument for Perusahaan Asuransi 8.80% Perkreditan Rakyat 1.10% improving people's welfare based on cooperative mechanisms". As one of economic actor, the role of BUMN as a manager of resources and production of goods, driven by the role of BUMN in other sectors, one of which is the banking sector.

2) state-owned banks.

At first in Indonesia there are 5 (five) major state-owned banks that have different business characteristics. The five banks are PT Bank Negara Indonesia Tbk, PT Bank Mandiri Tbk, PT Bank Rakyat Indonesia, Tbk, PT. Bank Tabungan Negara,Tbk. and Bank Export Indonesia (BEI). Each bank has a diffferent business focus, the corporate finance sector run by BNI and Bank Mandiri, BRI focuses on the finance sector of Micro, Small and Medium Enterprises (SMEs), BTN is engaged in financing housing loans, BEI while engaged in the business sector financing of import and export trade.

Along with the development, BEI's license has been revoked by the BI and the operation turned into Indonesian Exports Financing Agency (LPEI). Revocation is based on Bank Indonesia's Decree No. 11/43/KEP.GBI/2009 September 1, 2009. (Bank Indonesia, 2009). This resulted in the government currently only has 4 (four) state that Mandiri, BRI, BNI and BTN.

a) Bank Negara Indonesia
   Bank Negara Indonesia established on 1946 as the first fully state-owned bank. At the beginning, BNI serve as the central bank of the Republic of Indonesia, until 1955 BNI converted to commercial banks. With total assets Rp 227.5 trillion, BNI is the fourth largest bank in Indonesia by assets. BNI bases serving corporate clients, commercial and consumers through an extensive service network. On 2010, BNI has over 1071 outlets excluding 5 overseas branches. (Bank Negara Indonesia, 2010)
b) Bank Mandiri
   Bank Mandiri was established on October 2 1998 as part of a restructuring program implemented by government of Indonesia. Consolidation was carried out at four state-owned banks: Bank Bumi Daya, Bank Dagang Negara, Bank Ekspor Impor Indonesia dan Bank Pembangunan Indonesia. Bank Mandiri base serving corporate, consumer, micro finance and commercial. In late December 2009, Bank Mandiri has had 1095 of domestic branch offices and 5 overseas branches. (Bank Mandiri, 2010).
c) Bank Rakyat Indonesia
   In 1992 BRI changed its legal entity and name to became PT. Bank Rakyat Indonesia (Persero) and still maintain its consistency to focus serve in micro banking, small and medium enterprises and inspired to strengthen the SME sector as the strength of the national economy.
d) Bank Tabungan Negara.
   Since the bank established on 1976, Bank Tabungan Negara remains focused on the core business as a provider of housing loans and a market leader in housing finance. BTN performance continues to grow and in 2009 made it into the top largest banks in Indonesia from the amount of assets and outstanding loans, in the same year BTN also made Initial Public Offering.

B. Business Issue

Based on PBI No.8/16/PBI/2006, the ownership restructuring has to be done no later than December 2010, however, BI can tolerate an extension period of time to the parties if there is a problem that cannot be resolved until the appointed time. As a result, the ministry of BUMN agreed to undertake Bank Holding Company to comply with the regulation. On February 2011, according to Parikesit Suprapto (Deputi bid. Perbankan dan jasa Keuangan Kementerian BUMN), holding of four banks was start effectively. However, the holding is still as virtual holding consist of four commissioner from each bank and Mr. Parikesit Suprapto himself as a chief of committee. (Investor Daily Indonesia, 2011)

The definition of virtual holding itself is:

"A virtual holding company does not have independent corporate status nor does it issue capital stock. It is an advanced business management approach to eliminate complex procedures required for acquiring corporate status while maintaining functions equivalent to those held by a holding company with corporate status." (The Bank of Tokyo-Mitsubishi UFJ, 2011)

Based on the background and the explanation above, as the issue business of this study are establishment of bank Holding Company in order to meet PBI No.8/16/PBI/2006 and the implementation of Basel III on the next few years.

II. BUSINESS ISSUE EXPLORATION

Associated with the establishment of the Bank Holding Company, the scope of this study are to describe the analysis of the virtual holding company as the current form of holdings, as well as the role of holding company of four state-owned banks in an effort to meet goals of international banking regulation Basel III.

A. Conceptual Framework

Conceptual framework of this study was formed for the purpose of exploring the issue of bank holding company formation business as a consequence of the majority shareholder in more than one bank in accordance with a single presence policy by Bank Indonesia and the possible impact of what will occur after the formation of bank holding company. With the description of exploration business issue, then the root problem of the study can be seen clearly and can provide business solutions in accordance with the needs and problems in this study. Picture below is the conceptual framework of this study.

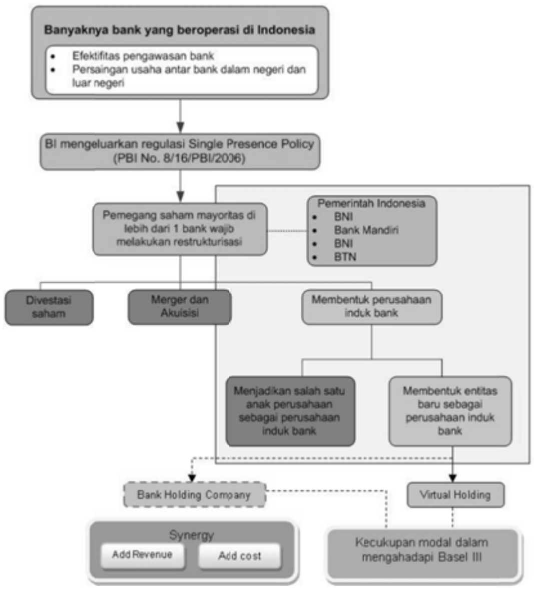

Figure II-1. Conceptual Framework

Single Presence Policy

Single Presence Policy aims to set the controlling shareholders of more than one bank is required to commit consolidation of their banks. Whereas, controlling shareholders is a legal entity and/or an individual and/or a business group which holds Bank shares amounting to 25% or more of shares issued by the bank and owns voting rights. (Bank Indonesia, 2006)

To meet the policy, there are three options given by Bank
Indonesia:

- To transfer a part or whole ownership on their shares to other party resulting that they only become a controlling shareholder in one bank,
- To implement merger or consolidation on banks under their control,
- To establish a bank holding company by establishing a new legal entity as the BHC or assigning one of banks under their control as the BHC.

Essentially, this policy aims to accelerate banking consolidation in order to achieve a stable and optimal Indonesian banking industry under Indonesian Banking Architecture supervision. In addition, other country that had been applying this regulation is Thailand with One Presence Policy, as a result, a certain numbers of merger and acquisition occur on their banking industry.

C. Review Options on Single Presence Policy

According to Single Presence Policy and its options, this section review of each option towards state-owned banks. The first option of the policy mentions that controlling shareholders to divest their shares. As BNI, Bank Mandiri, BRI and BTN are state-owned banks, their assets recorded as an asset of the country. Then, if this option is taken, it would reduce state assets directly. Moreover, the share purchase by foreign parties should be taking into consideration.

Meanwhile, regarding to merger and consolidation option, based on previous study determine that the best values of merger and acquisition scenario of state-owned banks is when BRI, BTN and Mandiri merge into one bank and acquire by BNI. (Saputro, 2011) . However, if it is taken, it will be against Peraturan Pemerintah No.28 tahun 1999 ayat 8 butir 2that said "requirements shall be met when a merger or consolidation, the assets of a bank merger or consolidation does not exceed 20% of all bank assets in Indonesia ". While assets composition of Indonesian banking to market shows below

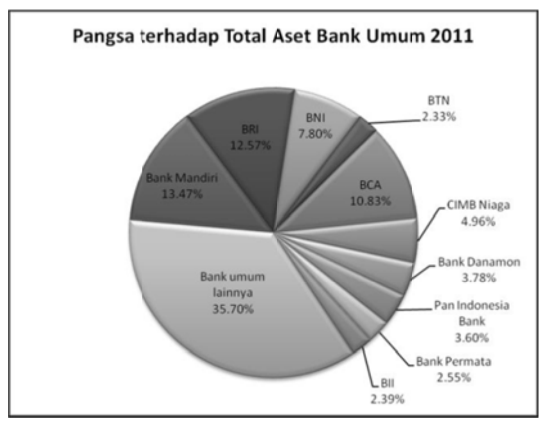

Figure II-2. Portion of Total Asset at Commercial Banks.(Statistik Perbankan Indonesia, 2011)

The third option of the policy is to establish a Bank Holding Company either to establish a new legal entity or assigning one of those state-owned banks as the BHC. The procedure of BHC establishment is under SE BI Nomor

9/32/DPNP. The establishment of holding company, specifically BHC or financial holdings, was carried out by some other government of other countries. For examples, Temasek Holdings owned by the government of Singapore and Khazanah Nasional owned by Malaysia government. Each of those holdings was take possession of financial holdings and banking group to form an investment portfolio from different core business of companies.

Based on the review of Single Presence Policy options, the most relevant and applicable option for state-owned banks is to establish a holding company in order to comply with the policy and expecting a greater value creation between those four major banks of Indonesia.

D. Value of Synergy

Consolidation is usually done for a particular purpose, in this case, consolidation made as an effort to meet the policy. But on the other hand, some parties also expect this situation resulted in value creation from synergies between the four banks.

Synergy is the additional value that is generated by combining two firms, creating opportunities that would not been available to these firms operating independently. (Damodaran, 2005). From the theory of value of synergy, Damodaran also stated that there are two sources of synergy, operating synergy that consists of: economies of scale, greater pricing power, combination of different functional strengths and higher growth in new or existing markets. The other source is from financial synergy that created from: debt capacity, tax benefits, combination of firms with different particular strength.

E. Basel III

In the implementation, Basel III requires a lot of new standardization for capital, debt structure, and liquidity. The purpose of standardization itself is to strengthen the regulation, supervision, risk management and banking sectors. Standard capital and new capital buffer requires banks to have greater capital and better quality than the Basel II regulations. (Moody's Analytics, 2012).

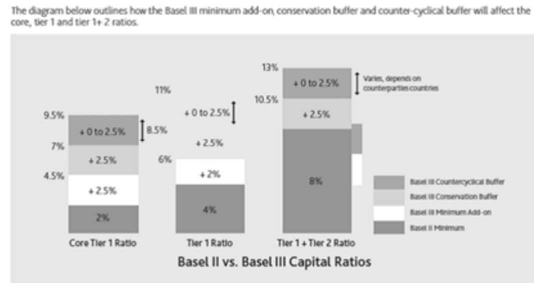

Figure II-3. Outline Minimum add-on, Conservation Buffer and Counter-cyclical Buffer. (Moody's Analytics)

Companies create value by investing capital to generate future cash flows at rates of return that exceed their cost of capital. The faster they can grow and deploy more capital at attractive rates of return, the more value they create. The mix of growth and return on invested capital (ROIC) relative to the cost of capital is what drives the creation of value. (McKinsey & Company, 2005). Corporate finance's strength (and greatest weakness) is its focus on value maximization. By maintaining that focus, corporate finance preserves internal consistency and coherence and develops powerful models and theory about the right way to make investment, financing, and dividend decisions. It can be argued, however, that all of these conclusions are conditional on the acceptance of value maximization as the only objective in decision making. (Damodaran, 2006) .

A. Valuing Banks

To valuing four state-owned banks, Equity cash flow method was utilized. The measurement of this method based from cash flow to equity and levered cost of equity as a discount factor. The Equity cash flow method is difficult to implement correctly because capital structure is embedded within the cash flow, this method is best used when valuing financial institution. For banks, however, we cannot value operations separate from interest income and expense, since these are the main categoriesof a bank's core operations. We need to value the cash flow to equity, whichincludes both the operational and financial cash flows. (McKinsey & Company, 2005)

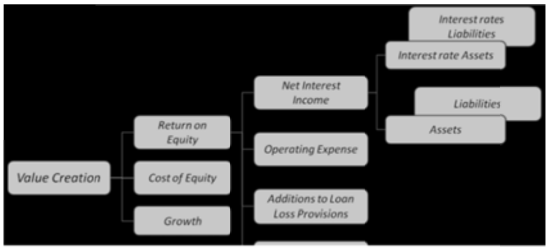

Figure III-1. Generic Value Driver Tree for Retail Banking Equif DCF Version (McKinsey & Company, 2005)

Based on the figure above, the formula of Equity DCF method is

B. Valuing Banks before Virtual Holding

Valuations at this stage of the calculation are done to get the value of company at the time of the pre-formed of Virtual Holding the state-owned banks in 2010. As data, this study use historical data from 2001-2010 and forecasted financial report five years forward. Valuation results:

Table III-1. Value to Equity (before virtual holding)

Banks	Value to Equity (Rp)	Shares	Value/sh (Rp)
BNI	79.134.581.311.648	18.648.656.458	4.243,45
Mandiri	143.679.342.980.410	20.996.494.742	6.843,02
BRI	285.897.045.772.051	12.334.581.000	23.178,50
BTN	7.420.908.031.646	8.714.056.001	851,60

C. Valuing Banks after Virtual Holding

To see the differences between condition before and after the existence of virtual holding, the following is valuation of four banks on 2011, with historical data from 2002-2011 and projected cash flow from 2012 to 2016

Table III-2. Value to Equity (after virtual holding)

Banks	Value to Equity (Rp)	Shares	Value/sh (Rp)
BNI	92.511.303.831,363	18.648.656.458	4.960,75
Mandiri	163.305.560.088,360	23.333.333.333	6.998,81
BRI	288.444.064.870,550	24.669.162.000	11.692,50
BTN	7.826.841.485,051	8.835.970.500	885,79

From the valuation before and after virtual holding, it can be seen that value of four banks were increased. However, based on value per share BRI's value is decreases, this is because on year 2011 BRI execute stock split. The table below is a change on value of four banks.

Table III-3. Change on Value (before and after)

Bank BUMN	Sebelum	Sesudah	% ΔVoE
BNI	79.134.581.311.648	92.511.303.831,363	17%
Mandiri	143.679.342.980.410	163.305.560.088,360	14%
BRI	285.897.045.772.051	288.444.064.870,550	1%
BTN	7.420.908.031.646	7.826.841.485,051	5%

D. Value if BHC

By building scenario if the form of holding was not a virtual but a real holding (BHC), this stage of valuation aims to determine the value if BHC to see the difference between virtual holding and bank holding. Assumptions of scenario:

- BHC has obligation to form a portfolio from the controlled companies
- Based on this case, two from four banks have similar core businesses which are BNI and Mandiri. Therefore, to make a portfolio these two banks have to run different core business.
- After portfolio was build, then the value of synergy could arise. Because with different business under one holdings, banks are allow to make cross selling. Which can provide add operating revenue, but also causes add expense for training human resources and marketing expense.

After scenario was build, resulting values of four banks below

Table III-4. Value if BHC

Bank BUMN	Value if BHC (Rp)	Porsi BHC	VoE BHC (Rp)
VoE BNI	115.292.996.299.981	60%	69.175.797.779.989
VoE Bank Mandiri	195.641.830.981.307	60%	117.385.098.588.784
VoE BRI	305.988.651.906.495	56.75%	173.648.559.956.936
VoE BTN	7.272.379.665.520	71.91%	5.229.568.217.475
TOTAL	**624.195.858.853.303**		**365.439.024.543.184**

E. Projected CAR of Four Banks

Using historical data from the core capital of RWA and publication of financial statements in www.bi.go.id to four state-owned banks in Indonesia, conducted pro forma analysis of the development of CAR for the next eight years, according to the plan of settlement of Basel III was completed in 2019.

Table III-5. Forecasted CAR – SOE Banks

Banks	2012	2013	2014	2015	2016	2017	2018	2019
BNI	17.41 %	17.72 %	18.02 %	18.33 %	18.65 %	18.97 %	19.30 %	19.64 %
MDRI	14.01 %	12.83 %	11.75 %	10.76 %	9.85 %	9.02 %	8.26 %	7.57%*
BRI	14.22 %	13.53 %	12.88 %	12.25 %	11.66 %	11.10 %	10.56 %	10.05 %*
BTN	14.92 %	14.67 %	14.42 %	14.18 %	13.95 %	13.72 %	13.49 %	13.26 %

Based on forecasted CAR of four banks, it can be seen that there are two banks will lack of CAR. Which are Mandiri and BRI

F. Conclusion of Business Solution

Based on the prior valuations and analysis, business solution that should be made is to establish a Bank Holding Company. Because with this form of holding, synergy values would be arising, so that could create a greater value creation of four state-owned banks. Moreover, with the establishment of Bank Holding Company, when banks cannot meet the minimum capital adequacy, BHC could provide capital injections or strategic direction to keep the banks' assets growth.

IV. IMPLEMENTATION

According to previous part, Bank Holding Company is needed to establish. This action made is not just to meet the policy, but also become needs of four banks. There are several matters related to the implementation of BHC:

- Schedule of implementation, and
- BHC from political viewpoint

A. Schedule of Implementation

Generally, schedule of implementation divided in two parts:

Plan phase and integration execution phase. On each phase there are activities that should be done, which are: due diligence, business, operation and IT integration and integration governance.

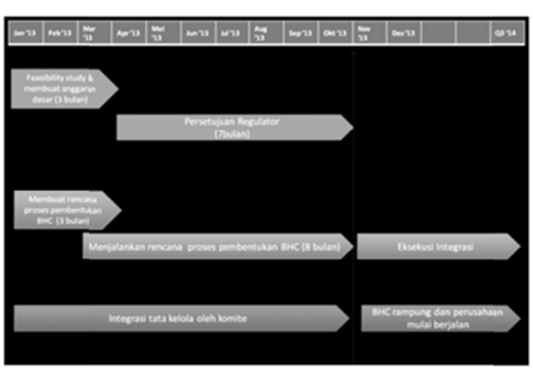

Figure IV-1. Schedule Implementation

Associated with regulatory approval, the following are parties to the regulatory authorities and approval must be met: Bapepam-LK ,Shareholders, Bank Indonesia or OJK (if operate already), Ministry of Law, Ministry of BUMN, Direktorat Jenderal Pajak.

B. BHC from Political Viewpoint

Given the bank which is the object of this study is state- owned banks, which would involve the government in which the inevitable political friction, but with still the same formation in the subsidiary if the BHC form, it is expected that political friction that occurs is minimal when compared to if merger is decided.

C. Implication of BHC to Industry Competition

Associated with the regulation of industry's competition , establishing the Bank Holding Company of each company's assets will remain in the position of each bank and no merge occurs. BHC as well defined as the holding company that controls and provide strategic direction, will not run as bank operations as well as four banks to be controlled so that the terms of the BHC itself does not conduct business in banking.

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